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# County of Los Angeles CHIEF EXECUTIVE OFFICE

Kenneth Hahn Hall of Administration  
500 West Temple Street, Room 713, Los Angeles, California 90012  
(213) 974-1101  
<http://ceo.lacounty.gov>

WILLIAM T FUJIOKA  
Chief Executive Officer

February 22, 2011

To: Mayor Michael D. Antonovich  
Supervisor Gloria Molina  
Supervisor Mark Ridley-Thomas  
Supervisor Zev Yaroslavsky  
Supervisor Don Knabe

From: William T Fujioka  
Chief Executive Officer

A handwritten signature in black ink, appearing to read "W. T. Fujioka", is written over the printed name and title.

Board of Supervisors  
GLORIA MOLINA  
First District

MARK RIDLEY-THOMAS  
Second District

ZEV YAROSLAVSKY  
Third District

DON KNABE  
Fourth District

MICHAEL D. ANTONOVICH  
Fifth District

## **RESPONSE TO BOARD ORDER OF JANUARY 18, 2011 TO MONITOR MUNICIPAL BANKRUPTCIES IN THE UNITED STATES THAT WOULD HAVE A DIRECT IMPACT ON OUR MUNICIPALITIES AND REPORT BACK ON THE COURT DECISION ON THE CITY OF VALLEJO BANKRUPTCY PLAN**

On January 18, 2011, Mayor Antonovich requested the Chief Executive Office to monitor municipal bankruptcies in the United States that would have a direct impact on our municipalities and report back on the court decision on the City of Vallejo bankruptcy plan.

### **Overview**

#### California Law

Existing law grants local public agencies in California broad access to Federal bankruptcy. The State statutes addressing municipal bankruptcy in California were first enacted under SB 338 of 1939. SB 768 of 1949 codified the State statutes which authorize bankruptcy filings by local governments.

In 2001, after studying existing statutes authorizing bankruptcy filings by local public entities, the California Law Revision Commission recommended revisions to conform the statutes to Federal bankruptcy laws and to reaffirm the intent of the statute to provide the broadest possible access to municipal debt relief under Federal law. Legislators approved the Commission's recommendations the following year (SB 1323, Chapter 94, Statutes of 2002).

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### Federal Law

Under existing Federal law, states do not have the right to file for bankruptcy and there are no bills currently being considered by Congress to amend the United States Bankruptcy Code to allow states the ability to file for bankruptcy.

According to the Federal Bankruptcy Court, in more than 60 years since the Congress established a Federal mechanism for the resolution of municipal debts, there have been fewer than 500 municipal bankruptcy petitions filed. Although similar to other bankruptcy provisions, Chapter 9 of the United States Bankruptcy Code is significantly different, in that, there is no provision in the law for liquidation of the assets of the municipality and distribution of the proceeds to creditors. Chapter 9 establishes several conditions before a municipality may file for bankruptcy. The municipality: 1) must be insolvent; 2) must have trouble securing agreements from creditors; and 3) must be specifically authorized by the state to file for bankruptcy.

### **Recent Developments**

#### House Oversight Committee Examines State and Municipal Debt Situation

On February 9, 2011, the Subcommittee on Financial Services and Bailouts of the House Oversight and Government Reform Committee held an informational hearing titled, "State and Municipal Debt: The Coming Crisis?" The purpose of the hearing was to understand the municipal debt crisis facing state and local governments, to assess its causes, and to consider available solutions. Committee members discussed possible scenarios if a state simply defaulted on some or all of its obligations, declaring itself unable to pay. However, no conclusion was reached as to recommendations for introducing a Federal bankruptcy bill.

#### Other Recent Developments

- The Center on Budget and Policy Priorities recently reported that 44 states and the District of Columbia are projecting budget shortfalls totaling \$125.0 billion for the upcoming fiscal year, which in most states begins in July, 2011.
- On January 24, 2011, U.S. House Majority Leader Eric Cantor (R-Va) stated that he opposes changing the Federal bankruptcy law that would allow fiscally pressed states to seek bankruptcy protection. Mr. Cantor also stated that there will not be a Federal bailout of states and state governments should not expect Washington to solve their fiscal problems. Additionally, Senate Minority Leader Mitch McConnell (R-Ky) indicated that he opposes state bailouts.

- In response to the possible introduction of Federal legislation by the Congress to allow states to file for bankruptcy, California Treasurer Bill Lockyer responded that states did not ask for such law, do not want it and do not need it. Mr. Lockyer added that bankruptcy would devastate states' ability to recover from the recession and it would inflict severe injury on taxpayers. Further, he added that advocates of this idea confuse states' near-term budget deficits with long-term funding obligations. The latter, including pension obligations, are serious problems, but states are dealing with them by reducing benefits and increasing employees' contributions. With respect to budget shortfalls, states have the tools to fix them without declaring bankruptcy.

### **City of Vallejo**

The City of Vallejo filed for bankruptcy in 2008. On January 18, 2011, the City filed a Plan For the Adjustment of Debts with the United States Bankruptcy Court. Submission of the plan is one of the final steps before the City can emerge from bankruptcy. The City's plan proposes to renegotiate labor contracts with its employee groups; develop a new employee benefits structure; reduce pension, retirement, health, and other benefits; and restructure capital and infrastructure projects.

According to documents submitted to the United States Bankruptcy Court, after several years of struggling to balance inadequate revenues with increasing expenditures, the City of Vallejo confronted the reality that it would be unable to pay its bills in early 2008. The City was driven to bankruptcy by a combination of declining tax revenues, as a result of the economic and housing market decline, and the rising cost of contracts with employee unions.

**The United States Bankruptcy Court has calendared a hearing for March 7, 2011 in which the Court will review the City of Vallejos' bankruptcy plan.**

We will continue to monitor municipal bankruptcy developments and will provide you with updated information regarding the Federal courts' decisions regarding the City of Vallejo.

WTF:RA  
MR:RM:er

c: Executive Office, Board of Supervisors  
County Counsel



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WILLIAM T FUJIOKA  
Chief Executive Officer

March 25, 2011

To: Mayor Michael D. Antonovich  
Supervisor Gloria Molina  
Supervisor Mark Ridley-Thomas  
Supervisor Zev Yaroslavsky  
Supervisor Don Knabe

From: William T Fujioka  
Chief Executive Officer

A handwritten signature in black ink, appearing to be "W. T. Fujioka", written over a horizontal line.

Board of Supervisors  
GLORIA MOLINA  
First District

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Second District

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Fifth District

## **STATUS REPORT IN RESPONSE TO THE BOARD ORDER OF JANUARY 18, 2011 TO MONITOR MUNICIPAL BANKRUPTCIES IN THE UNITED STATES THAT WOULD HAVE A DIRECT IMPACT ON OUR MUNICIPALITIES AND REPORT BACK ON THE COURT DECISION ON THE CITY OF VALLEJO BANKRUPTCY PLAN**

On January 18, 2011, Mayor Antonovich requested the Chief Executive Office to monitor municipal bankruptcies in the United States that would have a direct impact on our municipalities and report back on the court decision on the City of Vallejo bankruptcy plan. This is the second status report to provide a follow up of recent court actions regarding the City of Vallejo's bankruptcy plan and an update on new developments related to municipal bankruptcies.

### **City of Vallejo**

As reported on February 22, 2011, the City of Vallejo filed for bankruptcy in 2008, and on January 18, 2011, the City filed a plan for the adjustment of debts with the United States Bankruptcy Court. The City's plan proposes to: 1) renegotiate labor contracts with its employee groups; 2) develop a new employee benefits structure; 3) reduce pension, retirement health, and other benefits; 4) and restructure capital and infrastructure projects.

On March 7, 2011, the United States Bankruptcy Court conducted a hearing to review the City's bankruptcy plan and heard arguments concerning the adequacy of the plan. The Court heard presentations from City representatives on their strategy to exit bankruptcy and from retired employees expressing concerns regarding possible negative effects on their retirement benefits. Presiding Judge Michael McManus left the

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March 25, 2011  
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case open, but stated that the case has been pending long enough and he expects to hear final arguments on the City's plan to exit bankruptcy no later than June 2011. Judge McManus also stated that he plans to rule on complaints regarding proposed cuts to medical coverage lodged by a committee of retired City of Vallejo workers.

The next hearing is scheduled for April 11, 2011 to evaluate the City's revised plan.

### **Municipal Bankruptcy Recent Developments**

#### National Governor's Association

On February 26, 2011, the National Governor's Association (NGA) issued a statement warning that mere discussions about allowing state bankruptcy filings have resulted in increased state borrowing costs. According to the NGA, many Governors strongly oppose Federal proposals to allow states bankruptcy protection because such proposals create volatility in the financial markets, which negatively affect state's ability to borrow funds to conduct its operations.

#### Other Developments

On March 1, 2011, Boise County, located in the State of Idaho, filed for municipal bankruptcy protection due to its inability to pay a \$4.0 million judgment. Boise County, with a population of approximately 7,500 and an operating budget estimated at \$9.4 million, lost a Federal lawsuit brought by a developer of a proposed residential treatment facility for minors. The Boise County Assessor stated that the bankruptcy filing was not the result of revenue problems, but rather an attempt to maintain essential county services after suffering an expensive legal setback.

We will continue to monitor municipal bankruptcies and the City of Vallejo bankruptcy proceedings and will report back to your Board when major developments take place.

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County Counsel



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WILLIAM T FUJIOKA  
Chief Executive Officer

May 31, 2011

To: Mayor Michael D. Antonovich  
Supervisor Gloria Molina  
Supervisor Mark Ridley-Thomas  
Supervisor Zev Yaroslavsky  
Supervisor Don Knabe

From: William T Fujioka  
Chief Executive Officer

Board of Supervisors  
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## **STATUS REPORT TO THE BOARD ORDER OF JANUARY 18, 2011 TO MONITOR MUNICIPAL BANKRUPTCIES IN THE UNITED STATES THAT WOULD HAVE A DIRECT IMPACT ON OUR MUNICIPALITIES AND REPORT BACK ON THE COURT DECISION ON THE CITY OF VALLEJO BANKRUPTCY PLAN**

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### **City of Vallejo**

As reported on February 22, 2011, the City of Vallejo filed for bankruptcy in 2008, and on January 18, 2011, the City filed a plan for the adjustment of debts with the United States Bankruptcy Court. The City's plan proposed to: 1) renegotiate labor contracts; 2) develop a new employee benefits structure; 3) reduce employee benefits; and 4) restructure capital and infrastructure projects. On March 7, 2011, the United States Bankruptcy Court conducted a hearing to review the City's bankruptcy plan and heard arguments concerning the adequacy of the plan. However, Presiding Judge Michael McManus left the case open, but stated that the case has been pending long enough and he expects to hear final arguments on the City's plan to exit bankruptcy no later than June 2011.

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On May 25, 2011, Judge McManus approved the disclosure statement for the bankruptcy plan, which contains a summary of the City's post-bankruptcy plans, and the bankruptcy exit plan would be sent to creditors in the coming weeks. Creditors, including banks and former employees whose contracts and health benefits have been modified in the past three years of bankruptcy, will have a month to respond to the court. Objections by a committee of retired city employees were addressed in the updated plan, and no further objections have been logged to date.

Prior to the City of Vallejo's exit from bankruptcy, creditors will have an opportunity to vote on the exit plan and their votes will be taken into consideration by the Judge. The City's exit from bankruptcy could be confirmed at a hearing on July 28, 2011.

### **Municipal Bankruptcy Recent Developments**

As reported in the May 27, 2011 Sacramento Update, AB 506 (Wieckowski), as amended on March 31, 2011, would impose mediation requirement for local agencies prior to seeking Chapter 9 bankruptcy protection under the Federal bankruptcy process. Currently, Federal law authorizes municipalities to file a bankruptcy petition pursuant to Chapter 9 and provides financially-distressed municipalities protection from its creditors while the municipality develops and negotiates a plan for adjusting its debts. AB 506 would require local government agencies to participate in mediation prior to filing bankruptcy under Federal bankruptcy laws.

According to the California State Association of Counties, given the complex nature of governance and funding of public services in California, it is difficult to envision a mediation process, as proposed under AB 506, that would be timely and effective for local governments in fiscal distress. The League of California Cities indicates that AB 506 would create an obstacle course of new criteria and conditions that are replete with bias against local government agencies. AB 506 passed the Assembly Appropriations Committee by a vote of 5 to 3 on May 5, 2011 and is currently in the Assembly Appropriations Committee suspense file.

### **Other Bankruptcy Developments**

On May 26, 2011, the Rhode Island State Senate approved a proposal which would require municipalities to guarantee lenders first rights to their property taxes and general revenue in the event of a bankruptcy. The proposal still requires approval by the State's House of Representatives.



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According to Governor Chaffee's office, which drafted the proposal, the bill would improve the ability of all municipalities to borrow money in a challenging financial market. However, the Rhode Island League of Cities and Towns, which advocates on behalf of the State's 39 municipalities, has indicated that the proposal is not in the best interests of local jurisdictions. Peder A. Schaefer, Associate Director of the League, indicated that the current bankruptcy law is sufficient and that no other state requires cities and towns to adhere to such requirements.

We will continue to monitor municipal bankruptcies and the City of Vallejo bankruptcy proceedings and will report back to your Board when major developments take place.

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MICHAEL D. ANTONOVICH  
Fifth District

August 11, 2011

To: Mayor Michael D. Antonovich  
Supervisor Gloria Molina  
Supervisor Mark Ridley-Thomas  
Supervisor Zev Yaroslavsky  
Supervisor Don Knabe

From: William T Fujioka  
Chief Executive Officer

A handwritten signature in black ink, appearing to be "W. T. Fujioka", is written over the printed name and title.

## **FINAL REPORT TO THE BOARD ORDER OF JANUARY 18, 2011 TO MONITOR MUNICIPAL BANKRUPTCIES IN THE UNITED STATES THAT WOULD HAVE A DIRECT IMPACT ON OUR MUNICIPALITIES AND REPORT BACK ON THE COURT DECISION ON THE CITY OF VALLEJO BANKRUPTCY PLAN**

On January 18, 2011, Mayor Antonovich requested the Chief Executive Office to monitor municipal bankruptcies in the United States that would have a direct impact on our municipalities and report back on the court decision on the City of Vallejo bankruptcy plan. This report provides information on the recent court action regarding the City of Vallejo's bankruptcy plan and an update on new developments related to municipal bankruptcies.

### **City of Vallejo**

As reported on February 22, 2011, the City of Vallejo filed for bankruptcy in 2008, and on January 18, 2011, the City filed a plan for the adjustment of debts with the United States Bankruptcy Court. The City's plan proposed to: 1) renegotiate labor contracts; 2) develop a new employee benefits structure; 3) reduce employee benefits; and 4) restructure capital and infrastructure projects.

On August 5, 2011, Presiding Judge Michael McManus signed an order approving the City of Vallejo's bankruptcy exit plan after the City finalized the settlement language with Union Bank N.A., the City's primary creditor. Under the final plan, the City of Vallejo is

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responsible for \$46.0 million in principal owed to Union Bank, but the interest rate on the outstanding debt has been reduced from 7.25 percent to a maximum of 2.5 percent. Retirees are required to pay more for their health benefits and the City negotiated lower cost union contracts for current City workers. The City plan, however, does not alter financial securities which were tied to designated revenue sources, such as \$175.0 million in water revenue bonds, and other special tax obligations secured by special revenues within the City's restricted funds.

### **Municipal Bankruptcy Recent Developments**

**County-opposed, AB 506 (Wieckowski)**, which as amended on June 29, 2011, would impose a mediation requirement for local agencies prior to seeking Chapter 9 bankruptcy protection under the Federal bankruptcy process. Currently, Federal law authorizes municipalities to file a bankruptcy petition pursuant to Chapter 9 and provides financially-distressed municipalities protection from its creditors while the municipality develops and negotiates a plan for adjusting its debts. AB 506 would require local government agencies to participate in mediation prior to filing bankruptcy under Federal law, and follow mediation guidelines adopted by the California Debt and Investment Advisory Commission. Traditionally, a mediator is brought in to help resolve issues between parties who wish to come to a resolution. However, under AB 506, the mediator is granted extraordinary powers and all parties, even those not interested in a resolution, are forced into a mediation process.

Recently proposed amendments to AB 506 would remove the mandatory mediation requirement and provide for an expedited alternative procedure under a newly created Local Agency Bankruptcy Committee that would not require involvement by unions or retirees. According to the Chief Executive Office's Division of Benefits, Compensation, and Employee Relations, should the proposed amendments be included in the final language of the measure, the Chief Executive Office would recommend removal of the oppose position on this measure.

AB 506 passed the Senate Government and Finance Committee on July 6, 2011 by a vote of 6 to 3 and was referred back to the Senate Rules Committee. The author's office indicates that this measure may be a two-year bill as the author continues to work with the opposition to address their concerns. We will continue to monitor the measure's progress and report substantive changes to your Board.

### **Other Bankruptcy Developments**

According to various news accounts, Jefferson County, Alabama, home to Birmingham, the state's largest city, is considering filing for Chapter 9 bankruptcy to deal with

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\$3.2 billion in bond debt which was issued to finance an upgrade of its failing sewer system as a result of a Federal Court order. The bonds were linked to derivatives to protect the county if interest rates rose. However, the bond deals were plagued with pay-to-play and bid-rigging scandals that led to the convictions of several officials and refunding of fees from banks due to settlements with the Federal Securities and Exchange Commission. Compounding the county's fiscal crisis was a decision by the Alabama Supreme Court declaring a county occupational tax unconstitutional which eliminated 44.0 percent of the county's discretionary revenues. This has already led to the elimination of more than 500 jobs in Jefferson County.

On July 28, 2011 the Jefferson County Board of Commissioners delayed a vote on filing for bankruptcy for seven days to review a new offer from the county's creditors which was negotiated with the help of Alabama Governor Robert Bentley. The proposal would reduce the amount of principal owed and use state backing to lower the county's interest rate. Jefferson County would get debt relief through the creation of an independent borrowing authority which would issue bonds guaranteed by the State of Alabama. On August 4, 2011 the Board of Commissioners and its creditors extended a standstill agreement until August 12, 2011 to continue negotiating a settlement. Should the county decide to file for bankruptcy it would be the largest municipal bankruptcy in United States history.

As the City of Vallejo's bankruptcy exit plan will be approved by Judge McManus, all further reports on municipal bankruptcies that have a direct impact on the County will be included in regular Sacramento Updates.

WTF:RA  
MR:KL:sb

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